

Why does underperformance of IPOs in the long-run become debatable? A theoretical review

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Abstract

Prior studies have examined Initial Public Offering (IPO) market performance in two different periods—short run and long run—in terms of two phenomena: the under pricing or short-run market phenomenon and the underperformance or long-run market phenomenon. To find out the possible theoretical reasons for the underperformance phenomenon, this study reviews the past literature on the long-run market performance of IPOs. The evidence on long-run underperformance of IPOs is not as widespread as that of short-run under pricing of IPOs. The previous researchers have explained long-run performance using behavioral theories, methodological issues and short-run under pricing theories. Some researchers have found that IPOs underperform marginally or have no abnormal performance in the long run; thus, they do not reject the market efficiency hypothesis in the long run. Others have reported that IPOs over perform or do not underperform in the long-run market. Still others have argued that underperformance disappears when different performance measures or methodologies are used. The rest have found that IPOs underperform considerably in the long-run IPO market. However, the long-run underperformance of IPOs is a debatable issue among financial researchers because of their studies' conflicting results and controversial findings.

Keywords: Behavioral theories, Efficiency Market hypothesis, IPO, Underperformance

1. Introduction

Underperformance of IPOs is generally accepted as typical of long-run market performance, but it is not as widespread as short-run under-pricing of IPOs. Long-run underperformance indicates that the subsequent share prices are often lower than the first trading day prices, which provides negative abnormal returns for investors in the long run. Long-run market performance is a debatable issue among financial researchers as shown by the conflicting results and controversial findings they have obtained. Some researchers have found that IPOs underperform marginally or have no abnormal performance in the long run, which implies that the market is efficient because the results do not reject the market efficiency hypothesis in the long run (Gompers and Lerner 2003; Ibbotson 1975; Jenkinson and Ljungqvist 2001). Others have reported that IPOs overperform or do not underperform in the long-run market (Bird and Yeung, 2010; De Silva, Velayuthen and Walter, 2003; Thomadakis, Nounis and Gounopoulos, 2012). Some have argued that underperformance disappears when